

Audit Report no.26, 2000–2001

Defence Estate Facilities Operations

Department of Defence

Introduction

Background

- 4.1 The Defence Estate comprises the land, buildings and other facilities that Defence uses across Australia. These facilities are vital to achieving the Defence mission—to prevent or defeat the use of armed force against Australia or its interests.¹ The Estate has a gross replacement value of \$14.8 billion. Management of the Estate was dispersed across the various Groups in Defence until the Defence Estate Organisation (DEO) was created in 1997 to manage the Estate. This was done as part of the Defence Reform Program following a recommendation of the 1997 Defence Efficiency Review which suggested that an acceptable timeframe for the implementation of recommended changes was two to three years.²
- 4.2 Prior to the Defence Efficiency Review, funding for both capital works and facilities operations came from the Defence Portfolio

1 ANAO, Report No.26, 2000-2001, *Defence Estate Facilities Operations*, December 2000, p. 21; Department of Defence, *Defence 2000—Our Future Defence Force*, Commonwealth of Australia, October 2000.

2 ANAO, Report No.26, 2000-2001, pp. 21–22.

budget, with funding for facilities operations managed by Defence's individual Groups. Previously, responsibility for maintenance and minor new works rested with the establishment occupier/client, who had complete control of resources allocated for this task. Regional commanders were therefore able to determine maintenance and new work priorities for those facilities within their jurisdiction. As Defence explained at the public hearing: 'properties that the Army were on were Army properties and properties that the Navy were on were Navy properties'.³ The creation of DEO required significant changes in the culture, management approach and practices associated with facilities management.⁴

- 4.3 Since 1997, DEO's Facilities Operations (FACOPS) Program has delivered general maintenance and minor new works to Defence facilities on a regional basis across the country. DEO's Estate Operations and Planning Branch and its nine Regional Estate Centres (RECs) are responsible for the FACOPS Program. Resources available for the Program have been reduced in recent years. The total DEO budget for 2000–01, which included funds for capital works, facilities operations and property management, was \$2.6 billion. Of this total, the FACOPS Program had a cash allocation of \$213m and an additional \$15.6m for employee expenses associated with the Program's 283 staff.⁵ In 2001–2002, DEO's allocation was \$2.72 billion, of which \$235m went to FACOPS and \$17m was for salary and related items.⁶

Scope of audit

- 4.4 In Audit Report No. 26, 2000–2001, *Defence Estate Facilities Operations*, the audit objective was to assess the efficiency and effectiveness of selected Defence facilities operations, including tendering and contracting, with a view to making practical recommendations for enhancing operations. Relevant issues on facilities operations raised by Defence's Management Audit Branch (internal audit) in 1997, were addressed by ANAO in its audit.⁷

3 R Corey, *Transcript*, 2 May 2001, p. 51.

4 See DEO organisational diagram in ANAO, Report No.26, 2000-2001, p. 29.

5 ANAO, Report No.26, 2000-2001, p. 23.

6 Defence, Submission no. 9, p. 1.

7 ANAO, Report No.26, 2000-2001, p. 24.

- 4.5 The focus of the audit was on the following:
- DEO awareness of its 'clients', and client needs, given funding constraints;
 - The extent client requirements and identified corporate priorities are taken into consideration;
 - The tendering and management of DEO maintenance contracts in accordance with Commonwealth and Defence purchasing requirements (including Defence's *Chief Executive Instructions*);
 - The extent FACOPS management information system informed decision-making; and
 - How estate needs are identified so that works can be undertaken appropriately.

Audit findings

- 4.6 ANAO found that DEO had implemented many of the recommendations arising from the Defence Efficiency Review and had achieved savings through the reduction of duplicated services within each region and from the development and implementation of more efficient delivery methods. However, there was scope for improvement in various areas of the FACOPS program, particularly in relation to the management of contracts and resources.⁸
- 4.7 ANAO noted that significant staff reductions made within a relatively short timeframe had decreased the corporate memory, knowledge base and skills available to DEO. This drawback was further compounded by the introduction of new and significantly different management practices, yet there was no systematic monitoring by DEO of contract performance to check work done. Furthermore, not all DEO contract management staff had the appropriate skills to manage large, complex facilities maintenance contracts in the Defence environment.⁹
- 4.8 Following the creation of DEO, the emphasis was to deliver estate services on a priority basis by region rather than by individual establishment. In practice, this was not always the case, with variations in regional procedures resulting in a lack of transparency in decision making and with funding not always

8 ANAO, Report No.26, 2000-2001, p. 12.

9 ANAO, Report No.26, 2000-2001, pp. 53-55.

being applied to identified priorities.¹⁰ Because regular two-way consultation between DEO and some clients did not occur, this impacted adversely on DEO's ability to deliver the FACOPS Program efficiently and effectively, and on associated client satisfaction.¹¹

- 4.9 ANAO also found that maintenance of the Defence Estate was less than the property industry benchmark by about \$100 million in 2000–2001, although the makeup of the industry benchmark is ill-defined. As a result, it appeared that needed maintenance was being deferred—as was observed during the audit. The longer-term consequences of deferring maintenance have significant implications for Defence operational requirements, funding requirements and legal responsibilities.¹²
- 4.10 DEO does have limited control processes to ensure that agreed facilities work projects are completed according to priorities identified in the bid process. Currently, funds allocated to RECs are at times spent on lower priority work without consultation with and agreement by Central Office. While accepting the need for flexibility given the scale of the Program, ANAO argued that it was important that there be clear understanding and communication between the RECs and Central Office in order to ensure effective management and oversight of the pre-determined priorities.¹³
- 4.11 ANAO concluded that basic procurement requirements were not being met efficiently and effectively in all cases in some RECs. Examples found included continually extending standing offers without testing the market; continuing to use contractors' services when the contractual relationship was unclear; and awarding substantial amounts of work to contractors without seeking other quotes.¹⁴
- 4.12 Some staff demonstrated only limited awareness and ability to apply appropriate procedures relating to the commitment and expenditure of public money. ANAO was concerned that in some instances, documents relating to procurement decisions and necessary to support payments, had been unavailable to the audit

10 ANAO, Report No.26, 2000-2001, p. 74.

11 ANAO, Report No.26, 2000-2001, pp. 72–77.

12 ANAO, Report No.26, 2000-2001, pp. 91–93, 94–95.

13 ANAO, Report No.26, 2000-2001, pp.71–75.

14 ANAO, Report No.26, 2000-2001, p. 46.

team. Evidence indicated that purchase orders had frequently been raised with minimal supporting documentation. There had also been instances of purchase orders for more than \$1 million raised by staff without the appropriate authorisation or delegation. This was clearly contrary to Defence's *Chief Executive Instructions*.¹⁵

- 4.13 Undue emphasis on spending for the purpose of meeting expenditure targets is not in the Commonwealth's budgetary or contractual interests nor does it assist program efficiency. Yet ANAO found there was a continued focus on expenditure to achieve annual budget targets in DEO. Monthly expenditure of funds increased significantly towards the end of the financial year. In some cases there were overspends without approval. ANAO was told by the Estate Operations and Planning (EOP) Branch that over-spending was a positive outcome 'because it contributed to the overall achievement of budget targets by the Defence Portfolio'.¹⁶
- 4.14 Defence agreed with all six ANAO recommendations and advised that Defence Estate Organisation was supportive of the content of the audit and appreciated the consideration that ANAO gave to DEO's views in preparing the audit report.
- 4.15 The Committee examined the following issues at its public hearing on Wednesday 2 May 2001:
- Corporate governance
 - ⇒ Strategic Plan
 - ⇒ Chief Executive Instructions
 - Facilities maintenance
 - ⇒ Data collection
 - ⇒ Maintenance benchmark
 - Contract management
 - ⇒ Comprehensive maintenance contracts
 - ⇒ Staff training
 - Financial management
 - ⇒ End of financial year spending
 - ⇒ Sale and lease back

15 ANAO, Report No.26, 2000-2001, pp. 52-53.

16 ANAO, Report No.26, 2000-2001, p. 75.

Corporate governance

- 4.16 The Committee was told that DEO had made a significant effort to develop and implement a strategic, corporate-focused framework for the delivery of maintenance work through its FACOPS Program. Initiatives, such as the Comprehensive Maintenance Contract (CMC), focus on economies and efficiencies that earlier approaches and/or methods lacked. The introduction of Total Estate Management (a comprehensive approach to managing estate assets) is meant to provide firm data on the condition of the Estate in order to substantiate maintenance funding bids and to help prioritise maintenance.¹⁷ This was to replace the former practice whereby:

The Army, the Navy and the Air Force each managed their own facilities operations and under the guidance of a central organisation, but then they had sub-budgets down to bases and many of the decisions were at the discretion of the base commander, but they were still managed within a single service environment.¹⁸

- 4.17 However, ANAO found that variations in regional procedures resulted in a lack of transparency in decision making and funding was not always being applied to identified priorities.¹⁹ In effect, responsibility for maintenance and minor new works seemed still to rest with the establishment occupier/client.

Strategic Plan

- 4.18 In 1998, DEO prepared a Strategic Plan for Defence Estate as a guide for the next 20-30 years, 'justifying some of the decisions we were making in the way we were managing the estate'.²⁰ This Plan had been accepted by its Executive in December 1998 but had not received Government approval. When asked about this at the public hearing, Defence explained that the previous Defence Minister had wanted further consideration on several proposals.

The Strategic Plan projects which bases have a long-term future, which ones have a medium-term future and which

17 I McPhee, *Transcript*, 2 May 2001, p. 36.

18 Corey, *Transcript*, 2 May 2001, p. 37.

19 McPhee, *Transcript*, 2 May 2001, p. 37.

20 Corey, *Transcript*, 2 May 2001, p. 37.

ones have no future. In doing that, there were some implications that the Minister felt we needed to do some more work on before we put it to the government.²¹

4.19 This re-drafting was overtaken by the *Defence 2000* white paper, whose review of defence needs, strategic interests and objectives resulted in the DEO Strategic Plan being further revised. The amended version is to be considered by the Defence Committee in late 2001. Once it gains endorsement by the Defence Executive, the Plan will be submitted to the Minister for government consideration. Defence accepts that 'they may endorse it in principle but still want us to come forward with individual rationalisations, base closures and those sorts of things on a case by case basis.'²²

4.20 Furthermore, since the draft Strategic Plan was developed, DEO has developed a strategic facilities appraisal model to help it manage the entire asset life-cycle within a framework of strategic planning and management guidance:

We have a strategic facilities appraisal model which...talks about the capability contribution of the asset and grading it. There is an expectation that the ADF [Australian Defence Force] will give us input into what the capability contribution of each asset is. Then we will look at the condition of each asset, which is fairly simple for the industry to take on board, and look from that at the capability impact of not doing the work inside a restricted budget. That also has to be done in consultation with the Australian Defence Force.²³

4.21 Defence told the Committee that it anticipates that within its current budget limits, it can identify and apply a risk management profile to potential and required repair and maintenance work, by using Australian Standard 4360 on risk management.

We are going to migrate that across the entire estate so that we can look at occupational health and safety aspects, the risk of deterioration of the asset, and profile the risks that are being carried by the Department. In this way we believe we will be able to identify to the Executive what risks they are carrying and not just say,

21 Corey, *Transcript*, 2 May 2001, p. 58.

22 Corey, *Transcript*, 2 May 2001, p. 58.

23 Hammond, *Transcript*, 2 May 2001, p. 55.

‘The model says two per cent of the gross replacement value is what we should spend on maintenance,’ because that really does not tell us what a risk management profile would tell us.²⁴

- 4.22 The Committee acknowledges that the de facto implementation of the draft Strategic Plan has assisted to some extent the gradual culture change needed in Defence. However, based on the evidence received, it is clear that DEO still has some way to go in achieving the desired culture change.

Chief Executive Instructions

- 4.23 When questioned about the extent regional staff are aware of the *Chief Executive Instructions*, Defence acknowledged that staff were ‘probably not as aware as they should be’.²⁵ The Committee believes this is understating the situation, given ANAO found that, in the regional offices, staff were:
- Continuing to use contractors despite the contractual relationship being unclear;
 - Continually extending standing offers without testing the market;
 - Awarding substantial amounts of work to contractors without seeking other quotes;
 - ⇒ the total value of these contracts was \$900 000 in 1999–2000;
 - Mislaying current contracts and supporting documents in some RECs;
 - Raising some purchase orders, with minimum support documentation or without appropriate delegation or authorisation;
 - Sanctioning end-of-the-financial-year expenditure surges.²⁶
- 4.24 DEO assured the Committee that it was endeavouring to correct this situation. Annual workshops on *Chief Executive Instructions* were conducted for senior staff, who were then expected to pass on this training to more junior staff. ‘We have made a concentrated effort, particularly since the ANAO has highlighted

24 Hammond, *Transcript*, 2 May 2001, pp. 55–56.

25 Corey, *Transcript*, 2 May 2001, p. 55.

26 ANAO, Report No.26, 2000-2001, pp. 46, 48–49, 52–53, 77.

some of the deficiencies in the awareness of our staff, and we intend to continue that'.²⁷

- 4.25 The Committee believes that a filter-down effect is insufficient to achieve cultural change, given that in 2001, ANAO found that Defence's implementation of audit recommendations from its 1999–2000 report on Defence estate project delivery 'has had little effect'²⁸ and during this audit, REC staff 'were not aware that an updated version of the *Chief Executive Instructions* had been issued'.²⁹ In order to effect a culture change, Defence has to ensure that all line officers develop the practice of consulting the *Chief Executive Instructions* before they enter into any contract or agreement to purchase goods and services.

Facilities maintenance

- 4.26 Defence's official property asset register is held in its accounting system, ROMAN, which records the address and a unique property ID number against each property.³⁰ There is a sub-level database that contains more details on actual items such as plant, air-conditioning units and other equipment. This sub-level database, introduced in 1997, is called the Defence Estate Management System—Facilities Maintenance (DEMS/FM), which assigns a bar-code to each individual equipment system associated with each building.³¹ It is designed to standardise DEO's facilities maintenance software and create a comprehensive asset register of all Defence Estate property. It is managed by DEO and maintained and operated by an external contractor.

...(DEMS/FM) has the capacity to capture cost data against individual facilities and link this information to the appropriate user Unit. To date this source of data has not been used for reporting actual expenditure by the nine Regional Estate Centres.³²

27 Corey, *Transcript*, 2 May 2001, p. 55.

28 ANAO, Report No.26, 2000-2001, p. 77.

29 ANAO, Report No.26, 2000-2001, p. 77.

30 B Lane, *Transcript*, 2 May 2001, p. 57; Defence, correspondence with JCPAA, 2 May 2001.

31 Lane, *Transcript*, 2 May 2001, p. 57.

32 ANAO, Report No.26, 2000-2001, p. 30.

- 4.27 The Committee was told that the effectiveness of Estate management could be significantly improved if better information were available to target where scarce maintenance resources should best be spent.³³

This would include information on actual costs for attribution to Defence outputs and on the contribution each asset makes to Defence capability. ADF input is essential here, to ensure the estate management decisions are justified under Defence priority and cost effectiveness grounds.³⁴

- 4.28 As Defence itself acknowledges in its draft Strategic Plan for the Defence Estate:

While it is difficult to assess the validity of existing asset data, the trend in asset growth and in ageing is clear enough and has implications for maintenance (which tends to increase with age) and for overall estate management. Priority should be given to further development of the Defence Estate Management System (DEMS), and to the universal application of Asset appraisal—a maintenance planning process.³⁵

Data collection

- 4.29 Funding allocation in relation to the Defence Estate is made by the Defence Portfolio, with professional property management advice from DEO and military advice from the facilities users—the capability output managers. Effective management of the Defence Estate requires accurate and relevant data. At this stage, however, DEO lacks sufficient detailed data to support such advice.³⁶ ANAO found evidence to show that ‘DEO’s financial data is never absolutely accurate, and that it is not uncommon for DEFMIS [the former system] and ROMAN to vary by several million dollars, with no way of judging which system is more accurate’.³⁷ This has impacted on DEO’s ability to manage accurately its expenditure against pre-determined budget targets.

33 McPhee, *Transcript*, 2 May 2001, p. 37.

34 McPhee, *Transcript*, 2 May 2001, p. 37; ANAO, Report No.26, 2000-2001, p. 12.

35 ANAO, Report No.26, 2000-2001, p. 96.

36 ANAO, Report No.26, 2000-2001, p. 35.

37 ANAO, Report No.26, 2000-2001, p. 84.

- 4.30 The Committee believes that comprehensive information is crucial, if informed decisions on maintenance funding and expenditure are to be made. This is especially so now that Defence funding for maintenance and construction has been reduced.

Defence Estate Management System—Facilities Maintenance

- 4.31 DEMS/FM was designed to be a single, authoritative source of asset data, used in support of estate management activities at any point in the asset cycle (planning, acquisition, operation, and disposal). It is available on the internet to all its users—including contractors—with encryption access.³⁸ DEO uses DEMS/FM to collate and interrogate its data. DEMS/FM was introduced into the RECs to provide staff with a common application for managing their facilities activities. Central Office should be able to review data input into the system.³⁹
- 4.32 Each financial year, FACOPS and each REC submit their asset maintenance bids via DEMS/FM in order to assist longer-term planning.⁴⁰ The Works Processing Module has been specifically designed to enable contractors to manage Work Requests and prepare invoices through DEMS/FM.⁴¹
- 4.33 DEMS/FM is linked to all DEO contracts and is used for tendering purposes because it is more comprehensive than the ROMAN data.⁴² DEMS/FM, however, cannot effectively interact with ROMAN⁴³, although work is underway to put those links in place. 'Linking ROMAN to DEMS/FM will further enhance the system to keep the official ROMAN data up to date'.⁴⁴ Currently, the Australian Valuation Office is conducting three year rolling audits to validate the ROMAN data.⁴⁵
- 4.34 Given this reliance on DEMS/FM, it becomes crucial for systematic recording of all facilities maintenance data, otherwise

38 ANAO, Report No.26, 2000-2001, pp. 80–81.

39 ANAO, Report No.26, 2000-2001, p. 80.

40 ANAO, Report No.26, 2000-2001, p 60.

41 ANAO, Report No.26, 2000-2001, p 81.

42 Defence, correspondence with JCPAA, 2 May 2001.

43 ANAO, Report No.26, 2000-2001, pp. 84–88; Defence, correspondence with JCPAA, 2 May 2001.

44 Defence, correspondence with JCPAA, 2 May 2001.

45 Defence, correspondence with JCPAA, 2 May 2001.

the regions are unable to make informed decisions when managing the Defence Estate. This could impact on their asset maintenance bids each year.

- 4.35 During the audit, ANAO found that there were a number of problems with DEMS/FM. There is no consistent and regular usage by REC staff, many of whom see its use to be limited to urgent and unforeseen property maintenance.⁴⁶ In addition:
- Connectivity problems exist, making the system very slow and causing frequent disconnections, as a result of the insufficient bandwidth available to some RECs and DEO out-stations.⁴⁷
 - Most REC staff have low user skills and many are unwilling to self-train.
 - ⇒ Some staff continue to use other applications to manage their facilities works.⁴⁸
 - There is a lack of consistency in terminology, descriptions and processes across the regions.
 - ⇒ Some of the Expenditure Groups and account codes under the current bid process no longer correspond with terms still in general use in the regions.⁴⁹
 - All the above make it difficult to extrapolate accurate reports from the database.
- 4.36 ANAO stated that the extent of inaccurate FACOPS Program data in DEMS/FM was unknown.⁵⁰ DEO was attempting to address this problem through the compulsory use of DEMS/FM and use of the terminology defined in the *DEMS/FM Documentation Manuals*.⁵¹ A DEMS/FM Development Team had been set up to analyse user practices in the regions, assess the technical difficulties and to provide limited training.⁵² The user interface will be made more user-friendly by means of another more commonly available application.⁵³
- 4.37 Despite these difficulties, Defence informed the Committee that it is reasonably confident that its register stays up to date since ‘we

46 ANAO, Report No.26, 2000-2001, p. 81.

47 ANAO, Report No.26, 2000-2001, p. 81.

48 ANAO, Report No.26, 2000-2001, p. 83.

49 ANAO, Report No.26, 2000-2001, p. 62.

50 ANAO, Report No.26, 2000-2001, p. 86.

51 ANAO, Report No.26, 2000-2001, p. 62.

52 ANAO, Report No.26, 2000-2001, p. 86.

53 ANAO, Report No.26, 2000-2001, p. 87.

are in a much better position now to understand exactly what we have in the Estate in comparison to what was the case a few years ago’.

When we look at the property asset register, one of the activities that we have developed, as part of the creation of the Defence Estate Organisation, is to identify all of the properties and assets.⁵⁴

4.38 Defence went on to say that ‘we have a fairly powerful motivator’:

...our contractors get paid based on what work they identify that they are doing. So if they identify an asset or we ask them to do work on it and it is not in our contract, they are going to very quickly identify it so that they can get paid. In this way, we have identified a significant increase in our asset database since we have let the comprehensive maintenance contracts.⁵⁵

Committee comment

4.39 Having considered the evidence, the Committee believes that Defence still has a problem regarding its asset and property registers. While it acknowledges that Defence is making an effort to achieve a full register and link it to ROMANS, the Committee is not satisfied that all the problems have been addressed effectively. It therefore endorses audit recommendation no. 6—‘that DEO make better use of its DEMS/FM system in the delivery of its FACOPS Program’—to which Defence has agreed. The Committee believes that Defence should provide greater incentives for REC staff to migrate all their Estate activities fully onto DEMS/FM.

Recommendation 4

4.40 The Committee recommends that the Defence Estate Organisation facilitate the consolidation of Regional Estate Centre activities fully onto Defence Estate Management System.

54 B Lane, *Transcript*, 2 May 2001, p. 56.

55 O Hammond, *Transcript*, 2 May 2001, p. 57.

Maintenance benchmark

- 4.41 ANAO reported that the extent to which repairs and maintenance were carried out on assets was affected by the reduced allocations to the FACOPS Program. Spending was directed to the most essential tasks. This approach in turn affected the capacity of an asset to meet its usage objectives and to retain its valuation. In an attempt to improve matters, DEO has been developing systems to gather firm data so that it may substantiate funding bids and direct spending to essential tasks.⁵⁶
- 4.42 ANAO calculated that property industry benchmarks for recommended maintenance expenditure show that maintenance of the Defence Estate was underspent by \$100m in 2000–2001.⁵⁷ This indicated that needed maintenance was being deferred—with significant implications since Defence properties are ageing. In addition to impacting on operational requirements, deferral could also have implications for occupational health and safety and duty of care. The audit cited as supporting evidence ‘client dissatisfaction with discretionary funding levels and anecdotal evidence from regional Managers Defence Estate who consistently express concern at the under-funding’,⁵⁸
- 4.43 When questioned by the Committee about this underspend and the risks which were incurred, Defence agreed that:
- ...within Defence in the wider Defence budgetary context we have been under pressure for probably 10 years to establish relative priorities for capability versus support. ...we have established priorities not to maintain to the level that might be acceptable in a public arena, some of the assets that do not have a medium or a long-term life in the sense that where we are going to rebuild a base in the short to medium term or where we might adopt a different strategy for how we provide living-in accommodation for personnel, we have chosen not to invest in repairs of those assets.⁵⁹
- 4.44 Within the context of this risk management strategy for repairs and maintenance, Defence assured the Committee that there ‘are

56 ANAO, Report No.26, 2000-2001, p. 40.

57 ANAO, Report No.26, 2000-2001, pp. 40, 95.

58 ANAO, Report No.26, 2000-2001, p. 95.

59 Corey, *Transcript*, 2 May 2001, p. 38.

no instances that I am aware of where any major asset of that nature would be at risk'.⁶⁰

That is a risk we think we can manage without much difficulty. You may find instances where there are warehouses and storehouses, again because the base has not yet been redeveloped, where some of those assets may pose a risk to the items that are stored in them, but I would suggest to you that they would be only very isolated instances because we have taken the fire prevention measures and others to make sure that we can protect the assets that are inside those buildings to the extent that they need to be protected.⁶¹

- 4.45 Defence reiterated that the repairs that were being deferred were repairs on either non-essential assets that Defence had decided had no long-term future or were assets that performed a function where the function may change and be satisfied by a different strategy in the near future.⁶²

We have been prioritising maintenance needs ever since we took over the function from the Department of Administrative Services. There has never been sufficient funding to satisfy all the needs for maintaining buildings. So we have established a planning process where we have a bottom-up and a top-down process that come together at a reasonable level and a central level and where we involve all of the players in the game, apart from private lessees. We make judgments based on capability needs in the first instance and occupational health and safety in the second.⁶³

- 4.46 Questioned about whether any deferrals created a depreciation situation which placed major assets at risk, Defence asserted: 'The assets that are depreciating are probably ones that we will demolish and we will not spend any money on them at all.'⁶⁴

I would hate to think there were examples of our spending money on something that is being disposed of, but I am sure they probably are out there. The planning

60 Corey, *Transcript*, 2 May 2001, p. 38.

61 Corey, *Transcript*, 2 May 2001, p. 38.

62 Corey, *Transcript*, 2 May 2001, pp. 53–54.

63 Corey, *Transcript*, 2 May 2001, p. 53.

64 Corey, *Transcript*, 2 May 2001, p. 54.

system we have in place should ensure that that does not happen.⁶⁵

- 4.47 The Committee wanted to know if the Defence estate was being maintained in accordance with sensible business practices, especially where property may be earmarked for disposal. The Committee asked if any assets were at risk from being housed in properties which were being managed on a risk basis. On both counts, Defence assured the Committee that 'major assets of that nature' were not at risk.⁶⁶ Defence explained that repairs were 'done principally on a planning basis'.⁶⁷

We have part of the repair facilities operations devoted to 'urgent minor maintenance'. About 20 per cent is 'urgent minor maintenance', which you could describe as ad hoc. We would describe it as 'urgent minor maintenance'. It is probably less ad hoc than it is. The rest of it is planned maintenance.⁶⁸

- 4.48 Defence assured the Committee that maintenance was now based on a needs assessment and no longer simply on funds availability or 'on an ad hoc basis in response to user complaints' when previously scarce maintenance resources had not been well targeted.⁶⁹ Defence acknowledged this former unsatisfactory approach in its draft Strategic Plan when it pointed out that in the past 'a spate of mishaps...serves to highlight the risk Defence has taken in arbitrarily cutting maintenance to below industry recommended levels'.⁷⁰

Contract management

- 4.49 Most of the DEO contracts are in the regions. Each REC manages a different mix of facilities maintenance contracts in old and new forms because of the different contracting arrangements in each region prior to 1997, and from the different knowledge bases and capacities of regional staff. Although DEO allowed a timeframe of

65 Corey, *Transcript*, 2 May 2001, p. 54.

66 Corey, *Transcript*, 2 May 2001, p. 38.

67 Corey, *Transcript*, 2 May 2001, p. 54.

68 Corey, *Transcript*, 2 May 2001, p. 54.

69 ANAO, Report No.26, 2000-2001, p. 92.

70 ANAO, Report No.26, 2000-2001, p. 93.

two to three years for the implementation of recommended changes, most RECs have not totally converted.⁷¹

- 4.50 ANAO found that in some cases, formal contracts do not exist—even for work costing over \$250 000. In two instances, the contracts had been mislaid for over six months, yet regular payments continued to the contractors. ANAO concluded that ‘work awarded without reference to relevant contracts indicates poor contract management’.⁷²

Comprehensive maintenance contracts

- 4.51 Defence told the Committee that DEO had developed comprehensive maintenance contracts throughout the country, thereby replacing the general building/facilities and the fixed plant/equipment maintenance contracts, which ANAO found had been managed poorly.

The comprehensive maintenance contractors and our focus on planning and managing the contractor rather than actually managing the work will mean that we will be planning our work much more in advance than we did previously...⁷³

- 4.52 Under these contracts—initially for three years with the option to extend a further five, all the necessary personnel and resources to undertake the work specified are the responsibility of the contractors. Contractors are paid an agreed amount to maintain certain agreed standards. ANAO voiced two concerns in its report about these arrangements:

- Because comprehensive maintenance contracts are performance-based, there is an increased risk that only minimal preventative maintenance on fixed plant and equipment would be undertaken.
 - ⇒ The potential for under-maintenance leading to more rapid deterioration, and a shorter life of the asset, forms a major risk.
- A second risk is that such large contracts, when their terms expire, will simply be extended to postpone the tender and

71 ANAO, Report No.26, 2000-2001, pp. 41–43.

72 ANAO, Report No.26, 2000-2001, p. 46.

73 Corey, *Transcript*, 2 May 2001, p. 40.

assessment process—as had been done in the past—or even allowed to lapse while the work continues.⁷⁴

- 4.53 The Committee had similar reservations to those expressed by ANAO. It believes that the *Chief Executive Instructions* which are underpinned by the *Financial Management and Accountability Act 1997* should be adhered to during management of contracts. Furthermore, the Committee reiterates that DEO should encourage all its staff to consult the ANAO's *Contract Management Better Practice Guide 2001*. Staff should be aware of their responsibilities when expending Commonwealth funds.

Outputs

- 4.54 The Committee asked Defence what steps had been taken to implement the audit recommendation that individual facilities' costs be directly linked to the relevant outputs and sub-outputs so that FACOPS program costs can be appropriately attributed to overall Defence outputs. ANAO had found that the costs attributed to outputs were not data-driven but based on management judgement, largely because DEMS/FM was incomplete and not linked to ROMAN.
- 4.55 Defence had agreed in principle to this recommendation, provided it was practical and cost effective to do so. In its submission, Defence told the Committee:
- Costs for discretionary work, breakdown work and unforeseen maintenance is being captured and attributed to individual assets. Contract fees for maintenance of fixed plant and project management are more difficult to attribute and there is reluctance among our servicing contractors to provide this detail. Negotiations have not been finalised.⁷⁵
- 4.56 Defence told the Committee that the comprehensive maintenance contracts will allow DEO to identify costs down to building level on a basis which will allow it to attribute directly the costs of maintaining all of the assets of the estate.⁷⁶

74 ANAO, Report No.26, 2000-2001, p. 51.

75 Defence, Submission no. 3, p. 3.

76 Corey, *Transcript*, 2 May 2001, p. 53.

ANAO access to contractor records

4.57 The Committee was concerned to read in the audit report that ‘none of the facilities maintenance contracts, including recent contracts reviewed in the present audit, provided for suitable Defence or ANAO access’.⁷⁷ The Committee had previously recommended in two of its reports that ANAO should be given access to third party premises and records. When asked whether DEO contracts had such access clauses, Defence replied that its recent contracts gave Defence access to view contractor records.

During the audit, we felt that those contract clauses were adequate for the ANAO to have access; they said that it was not. So we agreed with the ANAO that we would change the clauses in the contract to allow full access.⁷⁸

4.58 The Committee was pleased that Defence has undertaken to insert clauses into future contracts, giving ANAO independent access rather than through Defence. ANAO requires this direct access in order for it to perform its auditing duties.

Staff training

4.59 Staff numbers across DEO, especially in the RECs, have been reduced following the Defence Efficiency Review. ANAO found that the timing of some of these reductions impacted on the standard of contract management in the RECs, particularly where comprehensive maintenance contracts had not been fully implemented.⁷⁹ Since some of those exiting were senior military members, DEO feared that it was losing its corporate memory and experience base.⁸⁰ The Committee was told that staff remaining in DEO needed to have the appropriate skills and qualifications to manage large, complex contracts in the Defence environment and deliver the services required to fulfil DEO’s mission—namely managing the Defence estate to meet Government and defence needs.⁸¹

4.60 ANAO found that some DEO staff had only limited awareness and ability to apply appropriate procedures relating to the

77 ANAO, Report No.26, 2000-2001, p. 57.

78 Hammond, *Transcript*, 2 May 2001, p. 38.

79 ANAO, Report No.26, 2000-2001, p. 59.

80 ANAO, Report No.26, 2000-2001, p. 54.

81 ANAO, Report No.26, 2000-2001, p. 55.

commitment and expenditure of public money. Instances were cited in the audit report of staff lacking the skills to determine whether contractors had fulfilled their contractual obligations; staff's inability to properly certify monthly invoices for contractor payments; staff exercising delegations without understanding fully their responsibilities; staff unawareness of the need to consult the latest version of *Chief Executive Instructions*; and of staff overspends without approval, totalling \$3.8m.⁸² Added to this was the low skill level and familiarity with DEMS/FM, DEO's database, among REC staff.

- 4.61 In its submission, Defence stated that it had undertaken a skill survey and a training team had visited all regions.⁸³ At the public hearing, Defence said:

Staff training is a difficult one in that we have been progressively relocating the staff that do not have the skills, that are no longer necessary....With respect to people that are not capable of being retrained, we are placing them in other positions or giving them the option of finding themselves something else to do.⁸⁴

- 4.62 ANAO found that DEO had difficulties attracting and retaining appropriately qualified, skilled experienced staff.⁸⁵ Defence accepted that it has to review its workforce recruitment, development and retention policies with the aim of ensuring the availability of staff with appropriate qualifications and experience to meet its program objectives. It told the Committee:

We are progressively implementing a system of recruitment and retention of people. You have got to understand that the sort of skills that we give the people that manage the facilities operations activity and our capital investment program are in high demand outside, and we cannot compete with the private sector. We train them—and they poach them.⁸⁶

- 4.63 The Committee is aware of Defence's poor record in contract and project management, and is of the view that Defence still has a long way to go before DEO staff are able to effectively exercise

82 ANAO, Report No.26, 2000-2001, pp. 48-49, 52-3, 75, 77.

83 Defence, Submission no. 2, p. 5.

84 Corey, *Transcript*, 2 May 2001, p. 55.

85 ANAO, Report No.26, 2000-2001, p. 55.

86 Corey, *Transcript*, 2 May 2001, p. 55.

their responsibilities for properties and assets with a gross replacement value of \$14.8 billion. Staff need to be motivated to develop the abilities to prioritise timely maintenance, develop sound business practices and the skill to manage contractors. Defence needs not only to hone its performance indicators to reflect these skills but needs also to implement appropriate manpower replacement strategies.

Recommendation 5

- 4.64 **The Committee recommends that Defence review its performance indicators for Defence Estate Organisation staff so that staff are encouraged to develop essential management and financial skills.**

Financial management

- 4.65 Although DEO is supposed to deliver estate services on a priority basis by region rather than by individual establishment, this does not always occur.⁸⁷ ANAO analysis, based on final allocation and expenditure data for 1999–2000 rather than on the RECs' proposed works programs, indicated that there was limited alignment between approved budget allocations and actual expenditure. The audit found some significant mismatches between allocation and expenditure in the samples tested.⁸⁸

- 4.66 DEO Central Office issued some 26 Allocation Variation Advice notices to RECs over the financial year. ANAO commented: 'The value of continual allocation advice provided to the RECs is questionable if compliance with the advice is not mandatory.'⁸⁹

The work by the RECs in developing detailed bids and by EOP Branch in consolidating the bids, allocating funds and monitoring expenditure becomes nugatory if RECs can shift funds to lower priority work.⁹⁰

- 4.67 Currently, funds allocated to RECs are at times spent on lower priority work without consultation and agreement by Central

87 ANAO, Report No.26, 2000-2001, p. 12.

88 ANAO, Report No.26, 2000-2001, pp. 71–73.

89 ANAO, Report No.26, 2000-2001, p. 74.

90 ANAO, Report No.26, 2000-2001, p. 74.

Office. While accepting the need for flexibility given the scale of the Program, ANAO believes it is important that there be clear understanding and communication between the RECs and Central Office in order to ensure effective management and oversight of the pre-determined priorities.⁹¹

- 4.68 Because regular two-way consultation between DEO and some clients did not occur, this impacted adversely on DEO's ability to efficiently and effectively deliver the FACOPS Program, and on associated client satisfaction.
- 4.69 The reduced resources allocated to the FACOPS Program resulted in DEO developing systems such as Total Estate Management to gather firm data on the condition of the Estate that are needed to substantiate funding bids and to direct spending to essential tasks. Total Estate Management considers the entire asset life-cycle within a framework of strategic planning and management guidance. It aids resource management both in terms of analytical justification of proposals and better targeting of scarce resources.⁹²

End of year spending

- 4.70 The Committee questioned Defence on its practice of pressing the RECs to spend all their funds before the end of the financial year, thus resulting in a spending rush in May and June. This practice was contrary to the *Chief Executives Instructions*. ANAO had concluded that 'the practice of exhausting appropriations before they lapse is undesirable unless there is a commensurate advantage for the Commonwealth'.

So much expenditure in such a short time raises concerns that projects are chosen, designed and delivered in haste, and that the Commonwealth may therefore not be receiving value for money. It is also unclear how so many projects being managed in such a short time frame can be managed effectively.⁹³

- 4.71 Defence explained that under the previous accounting regime, it was penalised significantly because of the way its budget was structured. The following year's budget was based on its total expenditure in the previous year. 'If we did not achieve it, we

91 ANAO, Report No.26, 2000-2001, p. 79.

92 ANAO, Report No.26, 2000-2001, p. 33.

93 ANAO, Report No.26, 2000-2001, p. 75.

were penalised. We were doubly penalised: we did not spend it in the year in which we had it and we did not get it the next year as well.'⁹⁴

- 4.72 Defence assured the Committee that the present expenditure pattern is changing because DEO has a different way of contracting for work.

Under the new regime which we have now, with the comprehensive maintenance contracts in place throughout the country, we expect that that pattern will go away....we will be planning our work much more in advance than we did previously, so expenditure will occur in a much more stable pattern across the year. There will probably still be some elements of trending up expenditure as the year progresses, just because of the nature of the way the orders are placed. We are fighting that, and it is something we have been fighting for as long as I have been around the organisation. With the new contracts and the new emphasis on planning, we anticipate that we will win that battle.⁹⁵

- 4.73 Defence further explained that although orders may be placed progressively throughout the year, in reality, a lot of the work did not get placed until after the first or second quarter so the work was done around the country in the third and fourth quarters.

While it looks like you are rushing around and spending money for the sake of spending money at the end of the financial year, that is not the case...With the new accounting arrangements, the accrual budgeting arrangements, the incentive to achieve your cash budget is not as great as it was previously.⁹⁶

- 4.74 DEO told the Committee it was trying to encourage its staff to place orders before July so that contractors can commence in July. However, there is some staff resistance to this.⁹⁷ It has also moved advanced approval of projects to February-March of the preceding financial year to allow some documentation to be done, working on the basis of securing 70 per cent of their forward estimates. DEO expects this new approach will produce a more even

⁹⁴ Corey, *Transcript*, 2 May 2001, p. 40.

⁹⁵ Corey, *Transcript*, 2 May 2001, p. 40.

⁹⁶ Corey, *Transcript*, 2 May 2001, p. 40.

⁹⁷ Corey, *Transcript*, 2 May 2001, p. 41.

expenditure pattern thereby replacing the sudden leaps towards the end of the financial as in the past. 'But, again, design cannot be fully committed until the new financial year. That means we will get a slight J-curve but the gradient should improve after that.'⁹⁸ Unexpected emergencies such a cyclone or a flood would require that DEO's program be adjusted accordingly.

Sale and lease-back

4.75 When the Committee questioned Defence about its sale and lease-back arrangements and the extent these represented value for money relative to the Commonwealth continuing to own those assets itself, Defence responded: 'The government made a judgment that the sale and lease-back of those properties was in the best interests of the government.'⁹⁹

4.76 Asked to elaborate, Defence commented:

From where we sat in Defence we felt that some were marginal cases and others were less marginal. In a whole of government context, there may have been a different perspective put on it.

...on the basis that Defence would be occupying the building for perhaps 50 years, we thought that it did not make a great deal of economic sense from a Defence perspective to sell them and lease them back.¹⁰⁰

4.77 The Committee was told the government agreed to supplement Defence for the costs of the lease-back of those sales that did not make sense from a Defence perspective.¹⁰¹ Other arrangements were entered into, especially regarding the sale of buildings such as the Russell complex and Campbell Park which 'will be necessary for as long as we can see into the future'.¹⁰²

Retaining a percentage of the proceeds of property sales

4.78 The Committee was informed that the sale of Defence properties dated back to 1989, when the former Department of Administrative Services no longer looked after Defence properties.

98 Hammond, *Transcript*, 2 May 2001, pp. 41–42.

99 Corey, *Transcript*, 2 May 2001, p. 46.

100 Corey, *Transcript*, 2 May 2001, p. 46.

101 Corey, *Transcript*, 2 May 2001, p. 47.

102 Corey, *Transcript*, 2 May 2001, p. 47.

...there was an agreement of Cabinet at that time that we could, to give Defence an incentive to dispose and rationalise some of its properties, retain up to one per cent of the net revenue from disposal of Defence properties—that is, one per cent of Defence outlay. In today's terms, that is probably some \$150 million or \$160 million a year. That was in place until last year.¹⁰³

4.79 Questioned further, Defence explained:

There was no overall cap. It was just one per cent, and above one per cent we shared the proceeds fifty-fifty with the broader budget. If we achieved revenue of more than one per cent of Defence outlay, and say Defence outlay was \$15 billion so it would be \$150 million, then if we achieved \$200 million we would retain \$150 million and beyond that we would share fifty-fifty with the broader budget.¹⁰⁴

4.80 The incentive came from having this amount 'added on to Defence budget funding; it was not part of Defence budget funding. The Defence budget was \$11 billion, plus any revenue from return of sales, up to one per cent.'¹⁰⁵

4.81 When the Committee asked why Defence had originally needed an incentive to sell property, it was told that the Defence culture had had to be changed.

Within the Defence organisation, properties that the Army were on were [regarded as] Army properties and properties that the Navy were on were Navy properties, and they were not going to move for any reason.¹⁰⁶

4.82 Since then, however:

Everyone within Defence understands that they have to make maximum use of the resources, whether those resources are in terms of property or whatever. We have moved from 500 plus properties in 1991 to 380 now and there is a further 100 for disposal. Prior to 1990, we would probably have been lucky to dispose of 10 properties in the history of Defence.¹⁰⁷

103 Corey, *Transcript*, 2 May 2001, p. 48.

104 Corey, *Transcript*, 2 May 2001, p. 48.

105 Corey, *Transcript*, 2 May 2001, p. 48.

106 Corey, *Transcript*, 2 May 2001, p. 51.

107 Corey, *Transcript*, 2 May 2001, p. 51.

- 4.83 In 2000, the Government specified Defence properties where Defence was not to retain any revenue from the sales. Instead, the sale revenue was returned directly to the budget. 'That was \$500 million worth of property sales identified in last year's budget.'¹⁰⁸

In the Expenditure Review Committee of Cabinet last year [2000] and in the budget it was determined that the revenue from disposal of properties would be determined in the annual review of the Defence budget. In any one year the government left itself the flexibility either to let us retain the one per cent or to direct it to the general budget.¹⁰⁹

- 4.84 In the 2001–2002 Budget, Defence identified \$634 million as the amount 'for sale of assets' returned to DoFA—namely to consolidated revenue.¹¹⁰ The Defence *Portfolio Budget Statement, 2001–2002* stated that \$241 million from property sales will be allocated to Defence, 'in addition to the forward estimates and in addition to the White Paper funding increases'.¹¹¹ It was projected that the allocated amount from sales will be \$131.3m in 2002–2003, \$135m in 2003–2004, and \$140.5m in 2004–2005.¹¹² Defence will continue to be provided with rental supplementation in respect of commercial rent charged on leased back properties.

Committee comment

- 4.85 The Committee was satisfied that Defence has made an effort to spread its future expenditure over the full financial year. Matters could be improved were Defence to give a higher priority to financial and managerial training for all its REC staff.

Bob Charles MP
Chairman
29 August 2001

108 Corey, *Transcript*, 2 May 2001, p. 49.

109 Corey, *Transcript*, 2 May 2001, p. 50.

110 Defence, Submission no. 9, p. 1.

111 Defence, *Portfolio Budget Statement, 2001–2002*, Commonwealth of Australia 2001, p. 20.

112 Defence, *Portfolio Budget Statement, 2001–2002*, p. 20.